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THE PICTURE: I've said this for the past ten years: "The politicians never move until their backs are against the wall." Well, the Jarvis-Gann initiative has passed in California, and politicians from the Atlantic to the Pacific to Washington DC have received the message. The voters are fed up with government taxing and spending. In other words, the politicians are finally against the wall.

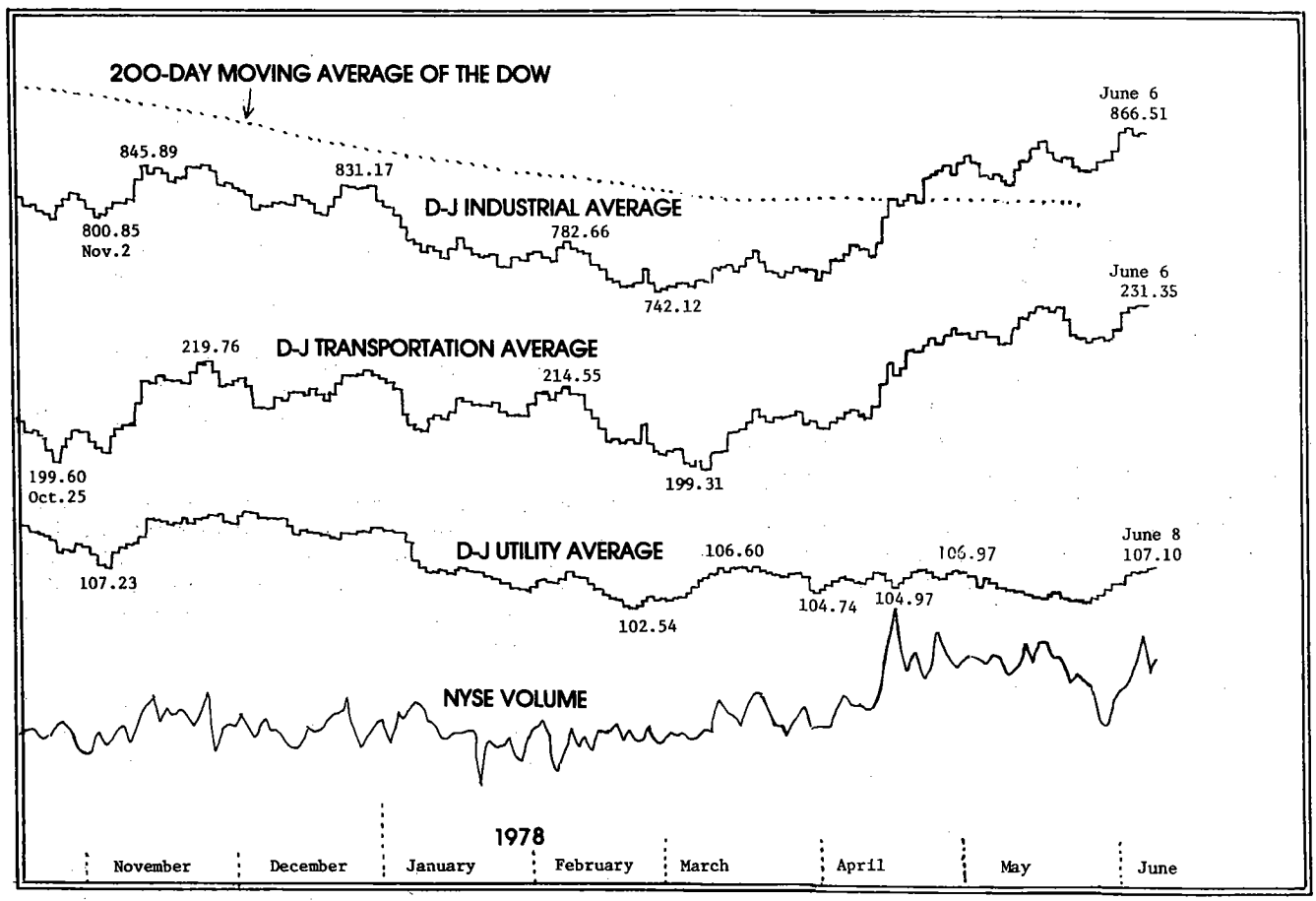
But it's not going to be as easy as simply cutting the taxes and cutting the boondoggling in government. That kind of action could have worked 20 years ago or maybe even 15 years ago. This nation now literally exists on a steady diet of expanding debt and depreciating dollars (inflation). The US has been financing its expansion and its interest-obligations with an increasing flood of depreciating dollars. What happens if Jarvis-Gann and other bills now force the various governments (city, municipal, state, federal) to cut back on their nonsense? The result could be deflation, an inability to service debt.

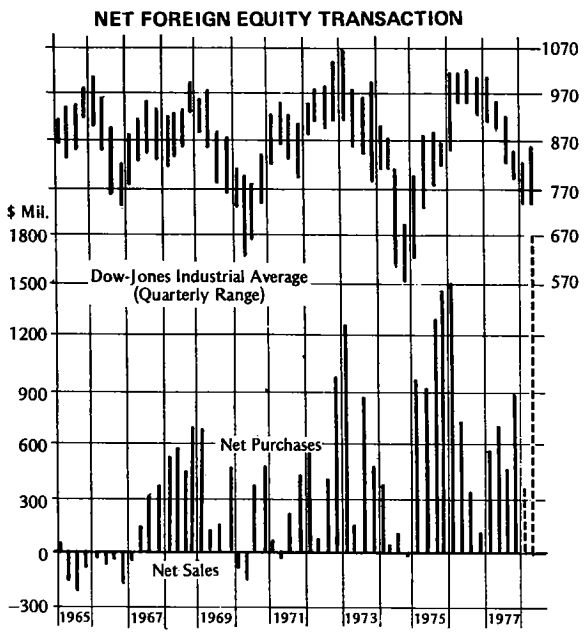
But the really important thing is that the **mood of this country is changing.** I've written before that the middle class (through taxes and inflation) is being systematically destroyed. The middle class is the most productive class in the nation, and their destruction will not come without a fight. The battle lines have been drawn, and the "great tax and spending revolt" is on. The implications should be dramatic indeed.

In a very recent study by the NYSE it was discovered that the US consumer is so upset by inflation that we have become a nation of *defensive* breadwinners. Interviewing hundreds of households with over $10,000 in earnings, it was seen that only one out of four families could afford or were interested in stocks, while most families said their highest goal was "to make ends meet."

Meanwhile, NYSE data for April shows that the shorts did not cover, and that the margin buyers added little to their portfolios. Furthermore, the mutual funds' cash was still high so they must have ignored the market. And institutions in general were rather cautious during the advance. The reason is clear enough: the institutions already are heavily in the market to the tune of 70% equity to 30% bonds.

I mentioned in Letter 731 that with the strengthening of the dollar a massive flood of foreign-held greenbacks have stormed the American shores, absorbing stocks in an almost frenzied effort to catch the turn (a rising dollar and rising stocks means a double profit to foreigners). Despite the popular folklore, however, foreigners have never been known for their astuteness in catching major bottoms and tops on Wall Street. This chart (courtesy of *Holt Advisory*, 277 Park Ave., NYC 10017) tells the story better than I can. Of particular interest is the surge of foreign buying in early 1973 just as the market was getting ready





to collapse. Then we see a drying up of foreign buying at the 1974 lows. The last dashed bar shows the estimated foreign buying during the second quarter of 1978.

In a recent study I showed where it has taken over 15 million shares on average to move the Dow up each point since mid-April. Why this massive churning volume? The obvious reason is that it is taking unbelievable buying volume to overcome the supply of stocks being offered as the Dow pushes higher. Who is supplying all this stock? My belief (based on odd-lot studies) is that the public has been a huge supplier. My odd-lot ratio is now near 300, indicating the public is selling almost 3 shares for every 1 purchased! What we could be seeing is a tremendous transfer of stocks from the portfolios of the American public to the eager arms of foreigners. If so, I would bet that the more correct sector is going to be the American public, not the foreign buyers. On a long term basis the US public has been a good judge of value (as gauged by return on investment) while foreign buyers have hardly been astute buyers or timers. (As an aside, I might add that the foreign rush into the now unbelievably inflated Southern California real estate picture is also a sight to behold. Prices foreigners are paying here are "beyond the blue horizon").

In the meantime, Wall Street has been churning up a storm. The momentum of the rally which began on February 28 has not been broken. The statistics are extraordinary. For instance, on June 8 the advance-decline ratio pushed fractionally to its highest level since 1974. On the same day the D-J 20-Bond Average fell to its lowest level in two years. Yet the market (on history's greatest volume) continued to push upward, this despite rising interest rates, despite a gathering squeeze in the financial and monetary markets, despite dangerously rising M-1 statistics, despite belated pressure from the Fed.

The diversity of opinions is remarkable. In its current report the widely-read *Holt Investment Advisory* recommends that subscribers "increase their short positions so that they represent 40% of their portfolios" and Holt openly talks about "the coming crash." Meanwhile *Joseph Granville* states that "The Dow is poised for a 100-300 point move straight up," and he hints of 1000 on the Dow. The *Bank Credit Analyst*, noting that "stock prices are likely to come under renewed pressure again with a distinct possibility, given the negative divergence between the trend of the debt and equity markets, of a decline to new bear market lows."

These are not the opinions of fools (and I could go on and on with such examples), but they are the views of some of the best minds in the industry. A friend called me from New York, a man I have been discussing the market with for almost 20 years, and he asked, "What's the most bullish thing about this market?" I answered, "I'm not saying this to be cute, but the most bullish thing about this market is that it's been going up! I have half a dozen bearish technical indices at this time and the monetary background is dismal, but the market is going up."

"Right," he answered, "and what does it remind you of?" "Late 1973?" I answered. "Well," he broke in, "it reminds me of 1929." I went back and read Robert Rhea's description of the great 1929 rise. *"I was not among those who followed the final swing.... The Averages were, of course, strongly bullish having jointly pushed into new high ground, but in the final months of 1928 money tightened, and my business needed every dime I could find. Auto sales were running at an unprecedently high rate, and I was content to have my funds in paper which returned a good rate. . . . when the crash came in September-October, it was with considerable satisfaction that I realized how I had not been sucked into the whirlpool of frantic trading. . ."*

Is the situation similar to Rhea's description; Are stocks going up mindlessly in the face of rising interest rates, record auto sales, rumors, tips, frenzied excitement? The similarities are obvious enough, but as Robert Rhea so often said, ***"Every man has to kill his own snakes,"*** and that's about the way I feel now.

The market has had a head of steam on it second to none, and from all "appearances" it wants to push itself right off the ground. If I had to think up a theme song for the 1978 market so far, it would be the old tune, "Fly Me To The Moon." But my own personal instinct is to let it make the trip to the moon without me. I've never bought stock against a deteriorating monetary background and rising interest rates, and I guess I value my sleep more than I do potential profits.

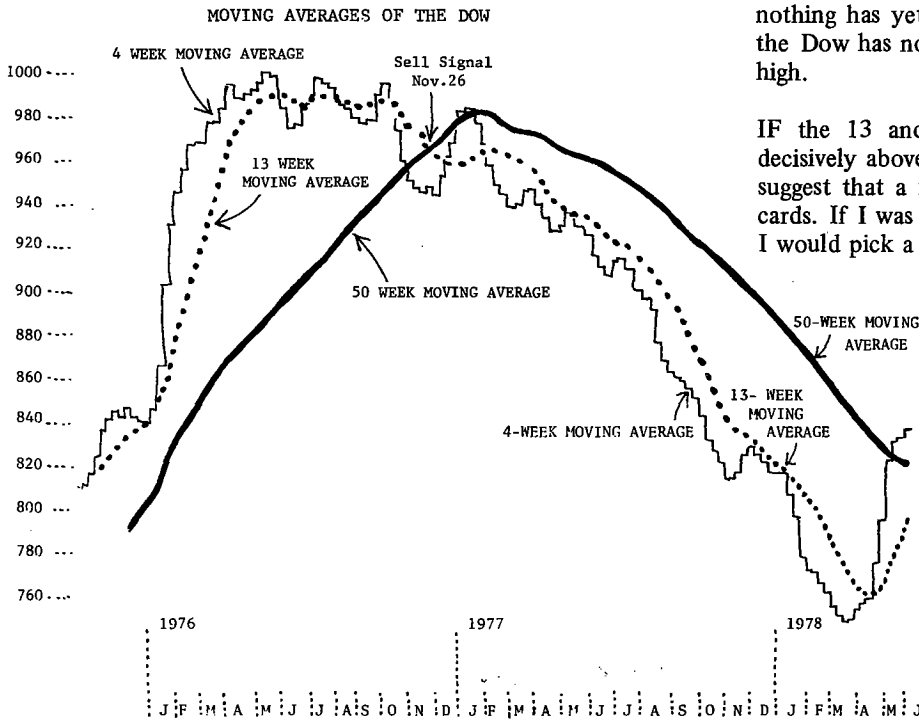
DOW MOVING AVERAGES: (See chart, page 3). This is the "fail safe" automatic technical device which I have used for years. As veteran subscribers know, I place most credence on the signals given by the moving averages when those signals occur IN HARMONY with the primary trend of the market.

The signals are provided in very simple fashion. The "alerts" are given when the short term or 4-week MA crosses above or below the 13-week MA. As you can see on the chart, a bullish alert was given in April, 1978.

The major signals are achieved when the 13-week MA crosses above or below the long term or 50-week MA. The last major signal was given in late November, 1976, at which time the 13-week MA dropped under the 50-week MA. This bearish signal has never been reversed, but the possibility of a crossing is drawing closer.

At present the 13-week MA is at 808, just 15 points below the 50-week MA which now stands at 823. At their present rate of closure, the 13-week MA could cross above the 50-week in a matter of two weeks (since they are closing at a rate of roughly 9 points per week).

Based on past history, if this is to be an historic advance then buying on an MA crossing should get the buyer in for the



largest part of that advance. On the other hand, it is my opinion that the current advance is a rally in a bear market, and for my own part I will probably forego any buying –even if the two lines do cross.

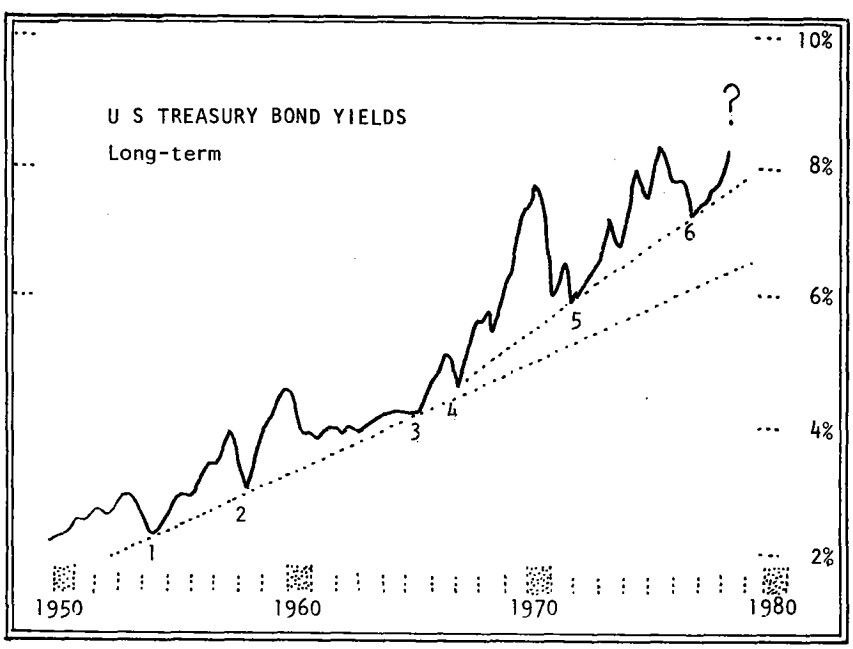
Many bear rallies of the past have ended with the two MA's just touching or on a minor crossing, but whether that will happen on this go-round no one can possibly know. I am well aware that "the market can do anything." I am also well aware that many subscribers act on their own, regardless of the concepts or ideas of Richard Russell. On this premise, I would say that nothing has yet been proved, and traders should remember that the Dow has not yet recovered half of the losses since the 1976 high.

IF the 13 and 50 week MA's cross and the Dow can push decisively above the 878 halfway (50%) level, such action would suggest that a further and perhaps impressive recovery is in the cards. If I was told that I had to put my money in this market, I would pick a decisive Dow penetration above 878 as the point at which I would hazard my funds. But since I don't HAVE TO shoot craps in the current market, I will pass on this rise and leave the profits to those who see the future in a more rosy light than I do.

HOW HIGH: I am reproducing below this set of statistics from my friend, Ned Davis's latest report (from J. C. Bradford & Co., Nashville, Tenn.). I thought it was both a fascinating and ominous set of figures, and it illustrates a point that I have been making continuously for months. The point is that budget deficits, when compounded at increasing interest rates, are dangerous and ultimately disastrous. Ironically, the kind of budget deficits listed on Ned's chart are at first highly inflationary. But in the end a structure of skyrocketing, compounding debt is deflationary. It is deflationary because there is no way in the world that it can be sustained–absolutely no way. So at some point in the distance, the debt structure must crumble, and at that time deflation takes over.

I am also including my own chart of long-term Treasury bond yields (bottom of page). To my mind, these Treasury yields constitute an absolutely critical indicator at this time. Why do I say that? First, long-term Treasury yields (unlike T-bills or short-term yields) can not be manipulated. They are therefore the surest and most accurate gauge of inflation trends. These yields are also an excellent measurement of the pressure in the money markets.

TIME	BUDGET DEFICIT	ULTIMATE PRIME RATE	ULTIMATE DISCOUNT RATE	ULTIMATE ANNUAL INFLATION RATE	ULTIMATE UNEMPLOYMENT RATE	ULTIMATE DOW BOTTOM
1963-1966	$16.1 billion	6%	4 1/2%	4.0%	4.0%	735.7
1967-1968	$33.9 billion	8 1/2	6	6.3	6.1	627.5
1970-1973	$63.3 billion	12	8	12.2	9.2	570.0
1974-1978E	$240 billion	?	?	?	?	?



On average over the last 100 years, long-term interest rates have tended to be 2% to 4% over the prevailing inflation rate. Since the inflation rate in the US is now around 10%, it is clear that the trend is up for long-term Treasury bonds.

As you can see on the chart, each yield base in Treasuries since 1950 has been at a *higher level than the preceding*. I have shown this with the numbers 1 through 6 on the chart. Note how rapid and shallow the decline in yields from the 1974 peak was. And note how quickly the yields advanced to the 1974 peak again. At this time the Treasury bonds are at their lowest price (and highest yield) in history. The bonds will constitute an excellent measurement of pressure on the money markets, and at some time ahead the Treasury bonds will also represent a great investment.

Along these lines my own feeling is that great fortunes will eventually be made by those who purchase US Treasury bonds at or near their final lows. The reason I say this is that the bonds offer the safest yields in the world. They are backed by the full faith and credit of the US Government. If these bonds don't pay off, nothing will pay off. Moreover, they can be leveraged very highly (most banks will lend 75% to 90% on US Treasuries). Thus, the man who buys a large quantity of Treasury bonds near the lows will have a very safe source of income plus the potential for a huge recovery in these bonds as and when interest rates come down.

In due time, we will have a great unwinding of the debt (deflation), and at that time I expect the Treasury (and other high-grade) bonds to enter a long and persistent bull market. As yields come down (perhaps to an eventual 4% to 6%) the Treasury bonds will head higher. Large holdings of these bonds will then produce both impressive income and major capital gains. (As an aside, interest on these bonds is exempt from state taxes).

BAHAMAS MONETARY CONFERENCE . . . NOTES: Paula and new baby Ryan and I fly from San Diego to Miami by night, along with stroller, infant seat, disposable diapers, 3 grips. We take off for the long flight via National Airlines. By midnight we're starving, whereupon we're fed "snacks" and liquor. National planes are dirty, ill-tended; movie sound system conks out (on return flight too!). I settle for two Bloody Mary's and sink into grouchy slumber. Next a three hour layover in Miami while we wait for connection to Nassau. We're told the plane is held up so it becomes four hours in Miami airport. More grouchy slumber.

At Nassau we're taken aback by the heat, humidity. It's about 90 degrees. We slug through customs, board a rickety little bus to the hotel. A 15 mile ride from the airport to the hotel looks like a tropical preview of deflation. Nassau is not pretty and clean like Bermuda (but I am told that the Freeport area is better). One third of the island's population is unemployed (population is 85% black and living on a subsistence level).

A bright moment: the Paradise Island Hotel is located right on the beach. We get to our room. Paula "adjusts" Ryan while I make a rush for the ocean. Amid a blast of heat and a blazing sun, I hurl myself into the clear azure blue water. The beach is fine, the water 86 degrees, the swimming excellent. Then I'm amazed to see two boys dropping pieces of bread into the water and the water comes alive with swirling fish 9 inches to a foot long. I'm looking at hundreds of Pompanos lunging for food, totally unafraid of humans. A boy gives me a piece of bread, and I'm besieged by fish. It's like standing in a living bowl of chowder!

The Conference turnout is huge. Advertised for 350, over 800 people arrive from all parts of the world, from Australia to Switzerland, from Costa Rica to Connecticut and California. The big guns are all there, Harry Schultz (Godfather to Ryan; they meet much to the delight of both), Harry Browne, Howard ("The Survivor") Ruff, Colonel Harwood, Jim Sinclair, Bill Tehan, Vern ("Deflation Man") Myers, and on and on.

Bill Tehan starts off with his thesis of a coming deflationary collapse via sky-rocketing interest rates and a squeezed money supply. Bill believes there is no way the Fed can "generate" super-inflation in our "credit economy." We're not a printing press economy, he states, but an economy built on endless credit extensions.

Vern Myers comes to the same final conclusions but with wrinkles of his own. He believes we're headed for blood-curdling deflation with gold climbing to "a minimum" of $300 in due time. It is clear that the lines are being drawn; inflation, then super-inflation and then collapse OR straight off deflation, perhaps chaos.

Harry Schultz wisely cautioned the audience that the "long term" used to mean a few years or more, then it meant about "three months" and today it means about "three weeks." Harry also warned about becoming emotionally involved with your holdings. Interestingly, Schultz has grown cool to silver, and he stated that it is not a particularly interesting investment at this time.

Harry Browne surprised the audience by saying that he believes gold has now adjusted to its inflation potential, and if it goes up from here (and he thinks it will in due time) it will because of the fear quotient. Harry also believes most of the currencies are about at their proper intrinsic value levels, with the exception of the pound which he feels is headed lower. Browne sees silver as undervalued. He also advocated holding warrants (perhaps instead of options). I agree with the last, and I will say more about this in a forthcoming Letter.

Stamp dealer and expert Myron Kaller pointed to the phenomenal past performance record of rare stamps. In a private conversation he told me that he believes rare stamps (unlike diamonds) are still in strong hands, and he sees the time when public participation in stamp buying will send the prices of these items through the roof. Mike emphasizes the need for expertise in purchasing stamps however, and warns against indiscriminate "collecting."

I could go on for pages, but I want to wind up this piece with a few of my own observations and thoughts. (1) I spoke to many attendees at the Conference. A surprising number were at a monetary conference for the first time. I would say that the majority of people I talked to were (a) well-heeled to wealthy, (b) highly intelligent, (c) eager to learn, (d) frightened or exasperated at the way the US and the world are going.

(2) Nassau has two gambling casinos, one located at our hotel. I'm convinced that there are three legal methods of stealing: (a) government-generated inflation, (b) taxes, (c) gambling. I thought it was pathetic to see people parted so rapidly and passively from their money. It was (at the casino) as if the victims couldn't wait to throw their hard-earned money away.

It occurred to me that one of my jobs is to try to take the gambling out of investing, to attempt to raise the risk-reward ratio, to try to teach people how not to lose their money. And there are those people in the casino losing tens, hundreds, thousands of dollars in a matter of hours. I can only think they're in a state of unreality or some kind of self-hypnosis.

The fact that gambling casinos exist is proof that they "take" the public. Casinos offer no service, no return, no educational lesson (unless it's that gambling is a sure way to thin out your wallet). But people continue to give away their money while calling it "fun." To my mind it's financial masochism, pure and simple.

(3) I noted that the majority of speakers at the Conference talked about values, history, techniques, economics, but very few talked about markets. Yet markets themselves are the

most fascinating phenomenon. The market (when all is said and done) is "where it's at." It's the actual markets that we have to deal with, and the markets that make or break us. Anyway, it is the markets that I talk about and that fascinate me.

As an aside, I would say that of all the markets, it's the money market which the speakers were least familiar with, the actual bond, muni, government and corporate markets. But that's exactly where I think the big news is going to come from! At any rate, it was a very interesting and instructive conference, and I learned a great deal.

NOTES AND QUOTES: The *Bank Credit Analyst* has arrived, and many of Editor Tony Boeckh's observations are well worth repeating. "Once again," he states, "we're facing an inflationary boom in the US of major dimensions." He adds, "There are a variety of . . . indicators of powerful imbalances and distortions, and at this stage of the cycle it is clear that meaningful restraint can only be postponed now at the risk of serious trouble." Boeckh notes that once again the Fed is alone in the inflation battle. Then very interestingly, Boeckh states that almost everyone is now prepared for higher interest rates, but "for interest rates to do their job, they must rise to a level that people and institutions cannot live with. The whole point of a credit squeeze is to choke off excess credit demands."

In other words, if inflation is to be effectively halted, the Fed must really put the brakes on. Barring that, inflation will run through the roof (as it is now doing). As I see it, Fed Chairman Miller has done the easy part of his job so far. He has clamped down "a bit," but not enough to halt inflation. From here on, stepping on the brakes will hurt. But the longer Miller holds off, the worse the ultimate shock is going to be. Or as Boeckh puts it, "The trend of interest rates remains up, and failing major fiscal restraint, the move is likely to be large."

Ironically, just as I was writing the above a subscriber called to tell me that he spoke to the "big boys" at a major US bank, and they told him "that they thought the prime rate would go to 10% but that money would still be available." I answered, "You mean that they're prepared for a 10% prime?" "That's right," my friend answered. "Then," I replied, "a 10% prime rate isn't going to slow anything down. The prime is going to have to go a good deal higher than 10%."

* *

I have received numerous questions from subscribers regarding the safety of US Treasury bills in the event of a collapse of a brokerage firm (who is holding the bills) or in the event of the collapse of a bank (who may be holding the bills). The NYSE brokers are now heavily insured and even so the bills are held by their banks.

In response to a question of the safety of the bills put to one of the largest banks in the nation, I received this interesting reply from the bank's legal department. The reply satisfied me.

"The Bank maintains a separate trustee book-entry account with the Department of the Treasury for the benefit of the Bank's customers for whom it acts as agent in purchasing T-Bills. In purchasing a T-Bill for its customer, the Bank notifies the Department of the Treasury of the name of its customer and the amount which the customer is investing. The Department of the Treasury enters the customer's name and amount on its books. All the funds represented by the Bank's customers' purchases are maintained in the trustee book-entry account referred to above. "If the Bank should go bankrupt, the creditors of the Bank could not attach these funds. Accordingly, the funds of the customer of the Bank would be safe and available to the customer even if the Bank should fail."

* *

The new *Esquire* arrived yesterday, and in it is an article entitled "Home Buying, Do It Now." I wondered whether the author had seen the new (10%) mortgage rates.

Coincidentally, on the same day I received a letter from a subscriber (BF, Davenport, Iowa) who is a construction executive. He writes, "As a general rule today, an average house in Chicago will be listed at $100,000 if it has just the minimum amenities. Let's assume that a young couple manages to save $20,000 to put down on the $100,000 house. They rush down to the S&L to consumate the deal. Here is the way it works out:

First year interest on $80,000 (at 10%)	$8,000
Closing costs of 3% (these are the "points")	2,400
To complete the paper work (why I don't know)	100
Total first year costs	$10,500

This works out to be 13;13% interest in the first year, on top of which they have to have top credit to even be considered!"

GOLD: Bill Tehan (at the Nassau Conference) made a few statements about gold and money that I felt were so important and fundamental that I want to repeat them verbatim. *"Many describe gold as a precious metal. We look at gold differently. Copper, lead and zinc are base metals; platinum and silver are decorative industrial metals and gold is money.*

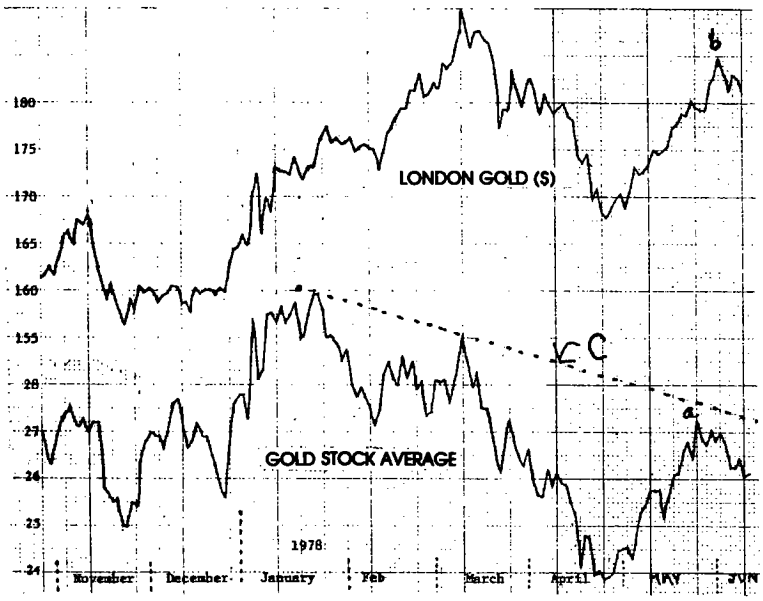
"Two of the basic characteristics of real money are: 1) it pays no interest and 2) it is an asset for which there is no corresponding liability. The 'money' which we carry in our pockets or in our bank accounts is an asset on our personal balance sheets, but a liability of the U. S. government on its balance sheet. The dollar is essentially a managed credit liability of the U.S. government. Thus, the value of our dollar assets is a function of the integrity of the management of the U. S. government."

In other words, gold is the only money-asset which has no lien or obligations against it. Other items (dollars, silver, Swiss francs, Treasury bills, C/D's, etc.) may be treated "as if" they are money, but gold alone IS money. It's a fascinating and very basic concept.

Despite the best laid plans of an ignorant (shall we call it a misinformed) US government, the use of gold as money (reserves) is spreading. The number of nations issuing gold coins as legal tender has rocketed from six in 1972 to 46 last year! The IMF has cut back on the size of its gold auctions and is now allowing part of the amount for sale each month to be available to the Less-Developed Countries at non-competitive bids. Why are the LDC's taking in gold (and they are)? Because they know that it's the one asset they can borrow against.

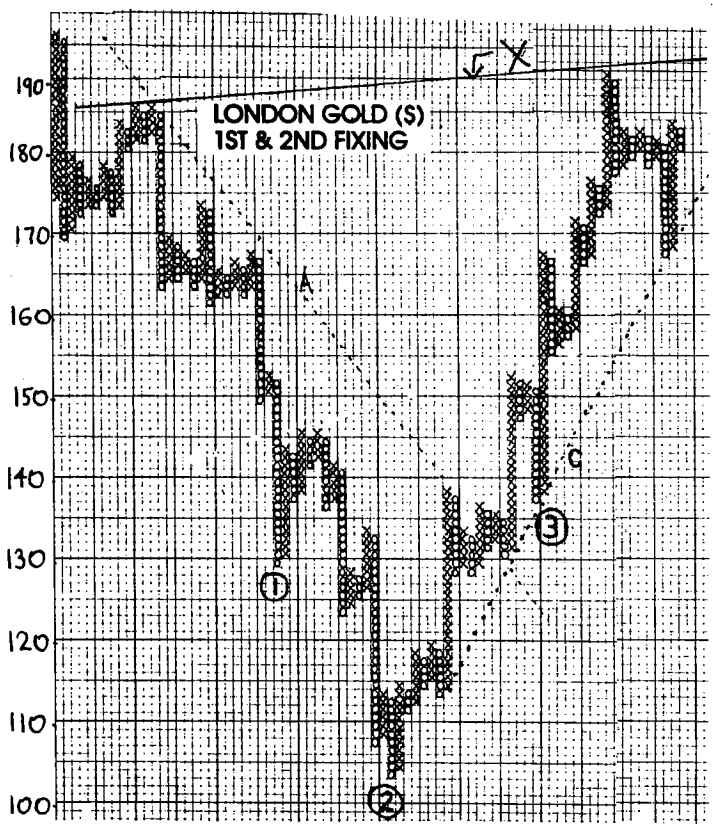
But back to the actual gold markets. In the last Letter I wrote that although I was bullish on gold, we are now in a "tricky area." And so we are. Note on my daily chart of the gold price and the gold stock average (GSA), that GSA broke to a new six month low in April, UNCONFIRMED by the bullion price. At the time I wrote that this had bullish implications, since a non-confirmation by one average usually indicates a general reversal to the opposite direction (in this case, up). The ensuing rally carried into late-May, taking bullion within 5 dollars of its March high of 190.

But note that again GSA turned down, this time at point "a" while bullion continued up to point "b". This is the reason I



grew cautious on the short term trend for gold in the last mailing. However, I have drawn the declining trendline C above GSA. If GSA can rally above that trendline with bullion confirming by bettering point "b" (at 185), we could have a big advance in both the gold shares and gold.

Turning to the point & figure chart, we are, in my opinion, still "working on" the right shoulder of the **huge head-and-shoulders bottom** in gold. Last week gold broke above the 178-183 consolidation pattern, and I would therefore label gold bullish on both the primary and secondary trends. If bullion (on any further correcting) can hold above its 13-week moving average (now at 178) it will appear very bullish. The upside target for bullion is now 185, then 190 (the year's high). If bullion can get above the resistance line (X on chart), it will have broken out of its massive head-and-shoulders bottom. It will then try for 197.50,

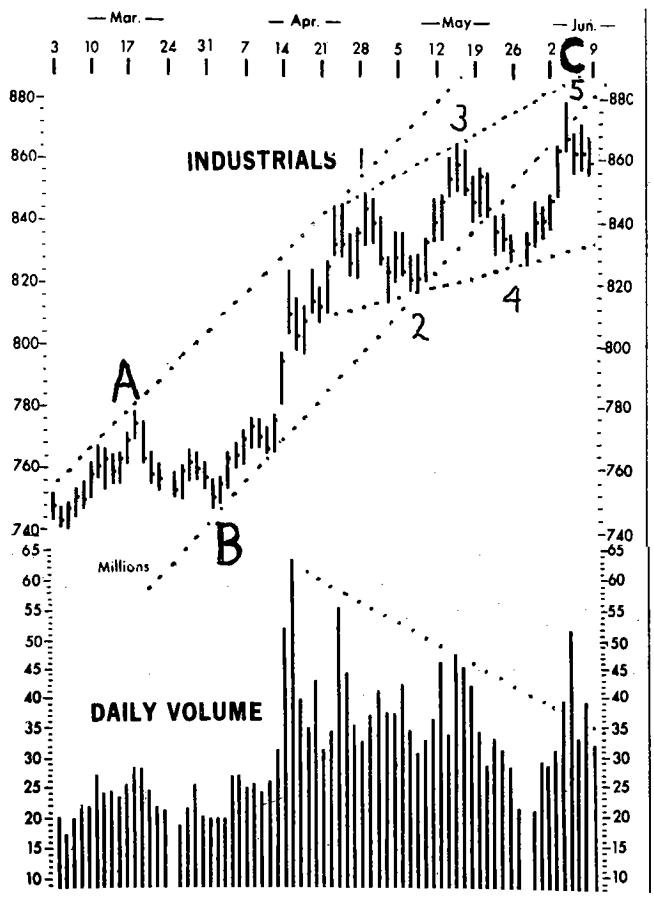


its all time high. And that's the technical picture for gold, a technical picture which I believe is a long-term bullish one, and an intermediate-term bullish one as well.

LATE NOTES: I include a daily chart of the Dow together with volume. Note that the Dow advanced along a steep channel to mid-May. But by June it was clear that a shallower channel had been formed by the Dow starting at point 1 in April. Both of these channels are delineated by the dotted upper and lower trendlines. It is probable that a great deal of distribution occurred within the second channel. I say that because the inter-day high for the Dow on April 26 (point 1 on the chart) was 846.15. Yet 28 trading days later (on May 9) the Dow closed at 859.23, only 13 points above the April 26 inter-day high! During that period approximately 1 billion shares changed hands.

I am still thinking that the whole rally since February 28 assumed the form of an Elliott A-B-C correction in a bear market, and I have numbered the chart accordingly. The advance to A and the decline to point B are clear enough. I now believe that the whole rise from B to C was a single (complex) wave, particularly since this is the wave that brought in consistently big volume. Leg C sub-divided into 5 smaller legs as shown. If this analysis is valid, then I would expect the Dow to sink below the 830 level or the level delineated by the lower trendline connecting points 2 and 4. If that happens, I would say that my next Letter will make interesting reading.

As a point of interest, note how volume has tended to subside as the 1-2-3-4-5 points were tracing out the most recent channel. It's almost as if buyers sensed that they were taking too much volume to do too little (following point 1), and they pulled back a bit on their buying enthusiasm.



NEXT MAILING: June 28th